

Internal Revenue Service

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Washington, DC 20224

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Date:

December 08, 2009

Legend

Company =

New Fund =

Adviser =

Adviser's General Partner =

State A: =

State B: =

Date 1 =

Number g =

Number r =

Number s =

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Fund 5 =

Fund 6 =

Fund 7 =

Fund 8 =

Fund 9 =

Fund 10 =

Fund 11 =

a =

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Dear

This is in response to the letter submitted by your authorized representative dated January 6, 2009, requesting rulings concerning the tax ownership of New Fund shares. Additional information was submitted in a letter dated October 21, 2009.

Facts:

Company is organized as a State A corporation. Company is registered as an open-end management investment company with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940, as amended (the 1940 Act) and its shares are registered with the SEC under the Securities Act of 1933, as amended (the 1933 Act). Company is comprised of Number g portfolios¹ that have each elected and qualified to be taxed as a regulated investment company (RIC) under subchapter M of

¹ Of the Number g portfolios, Number l are structured as feeder portfolios and Number s are structured as fund of funds.

the Internal Revenue Code of 1986. Pursuant to § 851(g)(1), each portfolio is treated as a separate corporation for federal income tax purposes.

New Fund is a newly formed series of Company that intends to elect and qualify to be taxed as a regulated investment company. Shares of New Fund will be sold only to separate accounts of insurance companies in conjunction with variable life and variable annuity contracts. New Fund will file a Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies, with an annual accounting period ending on Date 1, using an accrual method of accounting.

Adviser is organized as a State B Limited Partnership and is registered with the SEC as an investment adviser under the Investment Adviser's Act of 1940. Adviser will serve as investment manager to New Fund. Adviser is controlled and operated by its general partner (Adviser's General Partner) a State B corporation. Adviser files Form 1065, U.S. Return of Partnership Income, on a calendar year basis, using an accrual method of accounting. (Adviser may enter into an investment subadvisory agreement with one or more investment advisers under which such subadviser will make investment decisions to buy and sell securities and conduct research that leads to those purchase and sale decisions for all or a portion of New Fund's portfolio. Any such subadviser will be registered with the SEC as an investment adviser under the Investment Adviser's Act of 1940.)

Shares of New Fund will be offered exclusively to separate accounts of certain life insurance companies to support variable life and variable annuity contracts purchased by individuals (each a contract owner). The assets of an account are generally allocated among sub-accounts (each a sub-account) that correspond to the variable investment options under the contracts.

Contract owners will not be able to direct the New Fund's investment to any particular investment, including the Underlying Funds, as defined below, and there will be no agreement or plan between an insurance company and a contract owner or between Adviser and a contract owner, regarding any such investment. The contract owners will have no legal, equitable, direct, or indirect ownership in any of New Fund's assets. Rather the contract owners will only have a contractual claim against the insurance company to collect cash payments pursuant to the terms of the contract.

New Fund is a "fund of funds," which means that New Fund allocates its assets among other RICs, including Related Variable Funds and Public Funds. The Related Variable Funds are other regulated investment investments companies advised by Adviser or an affiliate of Adviser that, except as otherwise permitted by §1.817-5(f)(3) of the Income Tax Regulations, are offered to insurance company segregated asset accounts to serve as an investment vehicle for Variable Contracts. Public Funds are RICs that are available to investors other than through the purchase of a Variable Contract or as

otherwise permitted by § 1.817-5(f)(3) of the regulations. Underlying Funds are comprised of Related Variable Funds and/or Public Funds.

New Fund's primary objective is total return consisting of capital appreciation and current income. New Fund seeks to achieve its investment objective by purchasing shares of Underlying Funds to provide exposure to domestic and international equity and fixed income securities with moderate allocation to global equity securities.

The range of allocation of assets between Equity Underlying Funds, consisting of the Domestic Equity Underlying Funds and the International Equity Underlying Funds, and Fixed Income Underlying Funds for New Fund, under normal circumstances is shown below.

	Range
Equity Underlying Funds	<u>a</u> % - <u>b</u> %
Fixed Income Underlying Funds	<u>c</u> % - <u>a</u> %

Initially, New Fund is expected to invest in the Underlying Funds set out below, some of which are offered to the public (Public Funds) and some of which, except as otherwise permitted by § 1.817-5(f)(3), are offered exclusively to separate accounts of life insurance companies (Related Variable Funds).² Though it will be unknown to the contract owners, the initial target allocation for New Fund as set by Adviser is set out below opposite each Underlying Fund:

	Initial Target Allocation
Domestic Equity Underlying Funds	
Fund 1	<u>d</u> %
Fund 2	<u>e</u> %

² Shares of a Related Variable Fund may also be held by a "fund of funds" (such as New Fund), the shares of which fund of funds, except as otherwise permitted by § 1.817-5(f)(3), are offered exclusively to separate accounts of insurance companies.

Fund 3	<u>f</u> %
Fund 4	<u>g</u> %
Subtotal	<u>h</u> %
International Equity Underlying Funds	
Fund 5	<u>i</u> %
Fund 6	<u>j</u> %
Fund 7	<u>g</u> %
Subtotal	<u>k</u> %
Fixed Income Underlying Funds	
Fund 9	<u>l</u> %
Fund 10	<u>m</u> %
Fund 11	<u>l</u> %
Fund 12	<u>m</u> %
Subtotal	<u>o</u> %

This target allocation and the approved Underlying Funds may change from time to time in the sole and absolute discretion of Adviser without notice to New Fund's shareholders as long as the allocation maintains, under normal circumstances, (i) global equity exposure, and (ii) the equity/fixed income mix in the moderate allocation range described above. The target allocations will not be set out in New Fund's registration statement; rather it is contemplated that only the names of Underlying Funds will be set out in New Fund's registration statement.

From time to time, Adviser may add or remove Underlying Funds in New Fund's portfolio without notice to New Fund's shareholders. To maintain or adjust allocation ranges, adjustments may be made each business day by applying future investments in and redemptions from New Fund in proportions necessary to rebalance or adjust the investments in the underlying funds. In addition, Adviser will rebalance New Fund's portfolio at least quarterly, if necessary, by purchasing or selling shares of Underlying Funds to maintain or adjust allocation ranges.

In addition to changes in the allocation between Equity and Fixed Income Underlying Funds, Adviser in its sole and absolute discretion may also vary the allocation in other ways, including between Domestic and International Underlying Funds; the International Equity Underlying Funds will vary in their investments in emerging markets or developing markets and as to each among different geographic regions; with respect to Equity Underlying Funds, among large cap, mid cap, and small cap companies and within such capitalization ranges among value, growth and core styles, as well as exposure to equities and fixed income investments and real estate; and with respect to Fixed Income Underlying Funds, among investments with varying average maturities and credit ratings. Also, in addition to other short-term investments, New Fund may invest in affiliated and unaffiliated registered and unregistered money market funds to manage its cash pending investment in Underlying Funds or to maintain liquidity for the payment of redemptions or other purposes.

Adviser expects that New Fund's allocations to Underlying Funds and make-up of Underlying Funds will vary over time in order to achieve New Fund's investment objective based on market conditions that exist at any given time.

New Fund will comply with the diversification requirements of § 817(h) and, in accordance with these requirements, must treat each Public Fund as a single investment. Pursuant to such requirements, no more than fifty-five percent (55%) of the value of New Fund's total assets will be represented by any one investment, no more than seventy percent (70%) of the value of New Fund's total assets will be represented by any two investments, no more than eighty percent (80%) of the value of New Fund's total assets will be represented by any three investments and no more than ninety percent (90%) of the value of New Fund's total assets will be represented by any four investments.

Representations

In addition to the facts presented above, Company has also made the following representations:

- (a) Company is registered under the 1940 Act as an open-end management investment company.
- (b) New Fund is a newly formed separate series of Company, is a "fund" as such term is used in § 851(g)(2), and is treated as a separate corporation for federal income tax purposes pursuant to § 851(g)(1).
- (c) Each Underlying Fund has elected to be taxed as a regulated investment company under Part I of Subchapter M of the Code, and has qualified and

intends to continue to qualify for the tax treatment afforded regulated investment companies under the Code for each of its taxable years.

- (d) New Fund will elect to be taxed as a regulated investment company under Part I of Subchapter M, and intends to qualify for the tax treatment afforded regulated investment companies under the Code for each of its taxable years.
- (e) Except as otherwise permitted by § 1.817-5(f)(3), all of the beneficial interests in New Fund are held directly or indirectly by one or more segregated asset accounts of one or more insurance companies and public access to New Fund is available exclusively through the purchase of a variable contract within the meaning of § 817(d).
- (f) Except as otherwise permitted by § 1.817-5(f)(3), all of the beneficial interests in Related Variable Funds will be held directly or indirectly by one or more segregated asset accounts of one or more insurance companies and public access to Related Variable Funds will be available exclusively through the purchase of a variable contract within the meaning of § 817(d).
- (g) The life insurance companies whose segregated asset accounts hold or will hold shares of Related Variable Funds are life insurance companies within the meaning of § 816(a).
- (h) The life insurance companies whose segregated asset accounts hold or will hold shares of New Fund will be life insurance companies within the meaning of § 816(a).
- (i) Each segregated asset account that will hold shares of New Fund will be a separate account registered with the SEC as a unit investment trust under the 1940 Act or exempt from registration under Section 3(c) under the 1940 Act.
- (j) New Fund will satisfy the diversification requirements of § 817(h) of the Code and § 1.817-5(b) of the regulations.
- (k) There is not, and there will not be, any arrangement, plan, contract or agreement between Adviser (or a subadviser) and a Variable Contract holder regarding the availability of New Fund as a subaccount under the Variable Contract, or the specific assets to be held by New Fund or Underlying Fund.
- (l) Other than a Variable Contract holder's ability to allocate Variable Contract premiums and transfer amounts in the insurance company segregated asset account to and from the insurance company subaccount corresponding to New Fund, all investment decisions concerning New Fund are, and will be, made by Adviser, any the subadviser(s) and the Company's Board of Directors in their

sole and absolute discretion. The percentage of New Fund's assets invested in a particular Public Fund will not be fixed in advance of any Variable Contract holder's investment and will be subject to change by the Adviser (or a subadviser) at any time.

- (m) A Variable Contract holder cannot, and will not be able to, direct New Fund's investment in any particular asset or recommend a particular investment or investment strategy, and there is not, and will not be, any agreement or plan between Adviser (or a subadviser) and a Variable Contract holder regarding a particular investment of New Fund.
- (n) No Variable Contract holder can, or will be able to, communicate directly or indirectly with Adviser (or a subadviser) concerning the selection, quality or rate of return on any specific investment or group of investments held by New Fund.
- (o) A Variable Contract holder does not have, and will not have, any current knowledge of New Fund's specific assets other than as may be required to be presented in periodic reports to New Fund's shareholders. A Variable Contract holder does not have, and will not have, any legal, equitable, direct or indirect ownership interest in any of the assets of New Fund. A Variable Contract holder only has, and only will have, a contractual claim against the insurance company offering the Variable Contract to receive cash from the insurance company under the terms of his or her Variable Contract.
- (p) Except as otherwise permitted by § 4982(f), all shares of New Fund will be held directly or indirectly by segregated assets accounts of life insurance companies that are held in connection with variable contracts, as defined in § 817(d), and New Fund therefore will qualify for the exception from federal excise tax provided by § 4982(f), unless a variable contract holder is treated as a shareholder of New Fund pursuant to the investor control requirements of Rev. Rul. 81-225, 1981-2 C.B. 12,³ and Rev. Rul. 82-54, 1982-1 C.B. 11.

Ruling Requested:

New Fund requests a ruling that the New Fund's investment in Public Funds will not cause the Variable Contract holders to be treated as the owners of the New Fund's shares for federal income tax purposes.

Law and Analysis:

³ Rev. Rul. 81-225 has been clarified by Rev. Rul. 82-55, 1982-1 C.B. 12, and clarified and amplified by Rev. Rul. 2003-92, 2003-2 C.B. 353.

Section 61(a) provides that the term "gross income" means all income from whatever source derived, including gains derived from dealings in property, interest and dividends.

A long standing doctrine of taxation provides that "taxation is not so much concerned with the refinement of title as it is with actual command over the property taxed – the actual benefit for which the tax is paid." Corliss v. Bowers, 381 U.S. 376 (1930).

The incidence of taxation attributable to ownership of property is not shifted if the transferor continues to retain significant control over the property transferred, Frank Lyon Company v. United States, 435 U.S. 561 (1978); Commissioner v. Sunnen, 333 U.S. 591 (1948); Helvering v. Clifford, 309 U.S. 331 (1940), without regard to whether such control is exercised through specific retention of legal title, the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. Christoffersen v. United States, 749 F.2d 513 (8th Cir. 1984).

Rev. Rul. 77-85, 1977-1 C.B. 12, considers a situation in which the individual purchaser of a variable annuity contract retained the right to direct the custodian of the account supporting that variable annuity to sell, purchase and exchange securities or other assets held in the custodial account. The purchaser also was able to exercise an owner's right to vote account securities either through the custodian or individually. The Internal Revenue Service (the "Service") concluded that the purchaser possessed "significant incidents of ownership" over the assets held in the custodial account. The Service reasoned that if a purchaser of an "investment annuity" contract may select and control the investment assets in the separate account of the life insurance company issuing the contract, then the purchaser is treated as the owner of those assets for federal income tax purposes. Thus, any interest, dividends or other income derived from the investment assets are included in the purchaser's gross income.

In Rev. Rul. 80-274, 1980-2 C.B. 27, the Service, applying Rev. Rul. 77-85, concluded that, if a purchaser of an annuity contract may select and control the certificates of deposit supporting the contract, then the purchaser is considered the owner of the certificates of deposit for federal income tax purposes. Similarly, Rev. Rul. 81-225, 1981-2 C.B. 12, concludes that investments in mutual fund shares to fund annuity contracts are considered to be owned by the purchaser of the annuity contract if the mutual fund shares are available for purchase by the general public. Rev. Rul. 81-225 also concludes that, if the mutual fund shares are available only through the purchase of an annuity contract, then the sole function of the fund is to provide an investment vehicle that allows the issuing insurance company to meet its obligations under its annuity contracts and the mutual fund shares are considered to be owned by the insurance company. Finally, in Rev. Rul. 82-54, 1982-1 C.B. 11, the purchaser of certain annuity contracts could allocate premium payments among three funds and had an unlimited right to reallocate contract value among the funds prior to the maturity date

of the annuity contract. Interests in the funds were not available for purchase by the general public, but were instead only available through the purchase of an annuity contract. The Service concludes that the purchaser's ability to choose among general investment strategies (for example, between stock, bonds or money market instruments) either at the time of the initial purchase or subsequent thereto, did not constitute control sufficient to cause the contract holders to be treated as the owners of the mutual fund shares.

In Christoffersen v. United States, supra, the Eighth Circuit considered the federal income tax consequences of the ownership of the assets supporting a segregated asset account. The taxpayers in Christoffersen purchased a variable annuity contract that reflected the investment return and market value of assets held in an account that was segregated from the general asset account of the issuing insurance company. The taxpayers had the right to direct that their premium payments be invested in any one of six publicly traded mutual funds. The taxpayers could reallocate their investment among the funds at any time. The taxpayers also had the right upon seven days notice to withdraw funds, surrender the contract, or apply the accumulated value under the contract to provide annuity payments.

The Eighth Circuit held that, for federal income tax purposes, the taxpayers, not the issuing insurance company, owned the mutual fund shares that funded the variable annuity. The court concluded that the taxpayers surrendered few of the rights of ownership or control over the assets of the subaccount that supported the annuity contract. According to the court, "the payment of annuity premiums, management fees and the limitation of withdrawals to cash [did] not reflect a lack of ownership or control as the same requirements could be placed on traditional brokerage or management accounts." Thus, the taxpayers were required to include in gross income any gains, dividends or other income derived from the mutual fund shares.

Section 817, which was enacted by Congress as part of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) (the "1984 Act"), provides rules regarding the federal income tax treatment of variable life insurance and annuity contracts. Section 817(d) of the Code defines a "variable contract" as a contract that provides for the allocation of all or part of the amounts received under the contract to an account that, pursuant to state law or regulation, is segregated from the general asset accounts of the company and that provides for the payment of annuities, or is a life insurance contract. In the legislative history of the 1984 Act, Congress expressed its intent to deny life insurance treatment to any variable contract if the assets supporting the contract include funds publicly available to investors:

The conference agreement allows any diversified fund to be used as the basis of variable contracts so long as all shares of the funds are owned by one or more segregated asset accounts of insurance companies, but only if access to the fund is available exclusively through the purchase of a variable contract from an insurance

company. . . . In authorizing Treasury to prescribe diversification standards, the conferees intend that the standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors. . . .

H.R. Conf. Rep. No. 98-861, at 1055 (1984).

Section 817(h)(1) of the Code provides that a variable contract based on a segregated asset account shall not be treated as an annuity, endowment, or life insurance contract unless the segregated asset account is adequately diversified in accordance with regulations prescribed by the Secretary of the Treasury. If a segregated asset account is not adequately diversified, income earned by that segregated asset account is treated as ordinary income received or accrued by the policyholders.

Approximately two years after the enactment of § 817(h), the Treasury Department issued proposed and temporary regulations prescribing the minimum level of diversification that must be met for an annuity or life insurance contract to be treated as a variable contract within the meaning of § 817(d). The preamble to the temporary regulations stated as follows:

The temporary regulations... do not provide guidance concerning the circumstances in which investor control of the investments of a segregated asset account may cause the investor, rather than the insurance company, to be treated as the owner of the assets in the account. For example, the temporary regulations provide that in appropriate cases a segregated asset account may include multiple sub-accounts, but do not specify the extent to which policyholders may direct their investments to particular sub-accounts without being treated as owners of the underlying assets. Guidance on this and other issues will be provided in regulations or revenue rulings under § 817(d), relating to the definition of variable contracts.

51 Fed. Reg. 32633 (Sept. 15, 1986).

The final regulations adopted, with certain revisions not relevant here, the text of the temporary regulations.

In Rev. Rul. 2003-91, 2003-2 C.B. 347, a variable contract holder did not have control over segregated account assets sufficient for the Service to deem the variable contract holder the owner of the assets. The variable contracts at issue were funded by a separate account that was divided into twelve (12) subaccounts. The issuing insurance company could increase or decrease the number of subaccounts at any time, but there would never be more than twenty (20) subaccounts available under the contracts. Each subaccount offered a different investment strategy. Interests in the subaccounts were available solely through the purchase of a variable life or variable annuity contract that qualified as a variable contract under § 817(d). The investment activities of each subaccount were managed by an independent investment adviser. There was no

arrangement, plan, contract, or agreement between the contract holder and the issuing insurance company or between the contract holder and the independent investment adviser regarding the availability of a particular subaccount, the investment strategy of any subaccount, or the assets to be held by a particular subaccount. Other than a contract holder's right to allocate premiums and transfer funds among the available subaccounts, all investment decisions concerning the subaccounts were made by the issuing insurance company or the independent investment adviser in their sole and absolute discretion. A contract holder had no legal, equitable, direct or indirect interest in any of the assets held by a subaccount but had only a contractual claim against the issuing insurance company to collect cash in the form of death benefits or cash surrender values under the contract. The Service concluded that, based on all the facts and circumstances, the contract holder did not have direct or indirect control over the separate account or any subaccount asset, and therefore the contract holder did not possess sufficient incidents of ownership over the assets supporting the variable contracts to be deemed the owner of the assets for federal income tax purposes.

Section 4982(a) imposes a tax on every regulated investment company for each calendar year equal to 4 percent of the excess (if any) of – the required distribution for such calendar year, over (2) the distributed amount for such calendar year.

Section 4982(f) provides an exemption from such excise tax as follows:

This section shall not apply to any regulated investment company for any calendar year if at all times during such calendar year each shareholder in such company was either – (1) a trust described in section 401 and exempt from tax under section 501(a), or (2) a segregated assets account of a life insurance company held in connection with variable contracts (as defined in section 817(d)).

For purposes of the preceding sentence, any shares attributable to an investment in the regulated investment company (not exceeding \$250,000) made in connection with the organization of such company shall not be taken into account.

ANALYSIS

In the revenue rulings discussed above, the Service took the position that if the holder of a variable life insurance policy or variable annuity contract possesses sufficient incidents of ownership over the assets supporting the policy or contract, the contract holder is viewed for federal income tax purposes as the owner of the underlying assets and, as a result, is currently taxed on any income and gains attributable to the underlying assets. The Service stated in Rev. Rul. 2003-91 that the determination of whether the holder of a variable life insurance policy or variable annuity contract possesses sufficient incidents of ownership over the assets of the separate account

underlying the variable life insurance contract or variable annuity contract depends on all the relevant facts and circumstances.

In the present case, the fact that New Fund may invest in Public Funds does not cause the Variable Contract holders to be treated as the owners of New Fund's shares for federal income tax purposes. In Rev. Rul. 82-54, the amounts held in the segregated asset account underlying a variable contract were invested as the contract holder directed in shares of any or all of three open-end investment companies ("mutual funds"). Each mutual fund represented a different broad, general investment strategy. Shares of the mutual funds were available only to insurance company segregated asset accounts. While the mutual funds themselves were not available to the general public, the mutual funds held common stocks, bonds and money market instruments, all of which were available for purchase by members of the general public. The public availability of the assets held by the mutual funds did not lead to the conclusion that the issuing insurance company was simply a conduit between the contract holders and their mutual funds or the underlying assets of the mutual funds. Rev. Rul. 82-54 held that the insurance company, not the contract holders, was the owner of the mutual fund shares.

Similar to the mutual funds in Rev. Rul. 82-54, the shares of New Fund are, or will be, available only to insurance company segregated asset accounts and will invest in assets that are available to the general public. In the current case, instead of investing in common stocks, bonds and money market instruments that are available to the general public, New Fund will, generally, invest in regulated investment companies and exchange trade funds that are available to the general public. Based on the representations and facts presented by the taxpayer, the Variable Contract holder in this case does not appear to have any more control over the assets held under their contract than was the case in Rev. Rul. 82-54.

In addition, although shares of Public Funds are publicly offered, it is not likely that the general public can replicate the overall performance of New Fund given Adviser's discretion and authority to change the investment at any time without notice to the contract owners and the allocation by New Fund of a portion of its assets to Related Variable Funds, which are only available to the public through the purchase of variable contracts. The investment strategy of New Fund provides Adviser with the right to change the investment allocation among Underlying Funds and the right to remove Underlying Funds at any time. This flexibility prevents the contract owners from replicating the performance of New Fund and from creating a portfolio that is substantially identical to what a contract owner's position would have been by directly investing in Underlying Funds.

Based on the representations presented by the taxpayer, New Fund does not represent an indirect means of allowing a Variable Contract holder to invest in a Public Fund.

Conclusion:

Based on the authority cited above and the representations and facts presented by the taxpayer, New Fund's investment in Public Funds will not cause the Variable Contract holders to be treated as the owners of New Fund's shares for federal income tax purposes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See § 11.04 of Rev. Proc. 2009-1, 2009-1 I.R.B. 1, 48. However, when the criteria in § 11.06 of Rev. Proc. 2009-1, 2009-1 I.R.B. 1, 49, are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/S/

Donald J. Drees, Jr.
Senior Technician Reviewer, Branch 4
(Financial Institutions & Products)